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International Economic & Energy Weekly

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27 September 1985

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27 September 1985

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International Economic & Energy Weekly

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Synopsis

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Iraq's recent attacks against Khark Island have increased the risk that Tehran might move to interdict oil shipments from the Persian Gulf. Although US imports from Persian Gulf countries are small, the United States would share the burden of any net supply shortfall as oil prices rose and oil companies diverted supplies in response to market pressures. 25X1

We believe that South Africa is unlikely to react to Western sanctions by cutting off supplies of strategic minerals to the import-dependent West. Even if some limited action were taken, such an embargo probably would be short lived and have limted impact on the West. 25X1

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Alan Garcia, sworn in as Peru's new president on 28 July, has moved swiftly to implement new economic policies to restore growth, improve social welfare, and reduce foreign dependency. Nonetheless, we foresee worsening economic conditions for some months and a continuing impasse in debt negotiations, which will cut off the country from the resources needed to reactivate the economy. 25X1

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International Economic & Energy Weekly

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27 September 1985

Perspective

OPEC: Saudi Arabia Throws Down the Gauntlet

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OPEC ministers will again face a seemingly intractable set of circumstances when they meet next Thursday in Vienna. Discussion of production quotas—purposely avoided at the July meeting—will apparently be the primary item on the agenda. Demand for OPEC oil has been running more than 1 million b/d below the organization's 16 million b/d production ceiling. While the majority of members have exercised remarkable production restraint over the intervening two months, it has still fallen upon Saudi Arabia to bear the brunt of the production cutbacks needed to support prices. Recent reporting, however, indicates Riyadh is now intent on using price discounting to raise oil production by about 1 million b/d in October. 25X1

The Saudi moves appear to formalize Riyadh's renouncement of its swing producer role, which has propped up OPEC's official price structure. Recently negotiated crude contracts reportedly reduce Saudi prices by as much as $3 per barrel in the current market by linking them to product prices. King Fahd has indicated that Riyadh has the right to set its prices unilaterally, as long as it remains within its quota of 4.35 million b/d. It is questionable whether the other members will acquiese to the Saudi action by holding their own production at, or near, present levels. Furthermore, the move comes at the same time Iraq's newly completed pipeline link to Saudi Arabia becomes operational. Planned increases in Saudi and Iraqi output would cover nearly all of the expected growth in fourth-quarter demand. 25X1

The escalating Iran-Iraq war may also polarize OPEC at a time when cohesion is essential to deal with an oil market that refuses to take the organization's actions seriously. While Tehran has threatened to match any increase in Iraqi exports, Baghdad's escalation of attacks on Khark Island may seriously affect Iran's capacity to increase crude exports. Indeed, there is a substantial risk that another major attack could knock out Khark exports entirely for an extended period, precipitating Iranian retaliation against Persian Gulf oil shipments. 25X1

Several other OPEC members also have the potential to undermine OPEC's tenuous balance:
- Despite the new government's verbal support for OPEC, the new Nigerian President has made it clear that oil policy will be based on "national interest." Nigerian production is beginning to climb significantly following price concessions to producing companies.
- Financially strapped Indonesia is also reported to be seeking new means to bolster slumping oil sales and revenue.

- Venezuelan oil exports climbed over 30 percent in August following price cuts on its heavier crudes and refined products.

Despite severe revenue pressures, many OPEC members have been willing to act with restraint over the past several months on the presumption that they would be able to share in the general rise in winter exports. In the face of aggressive Saudi and Iraqi marketing tactics, however, these countries may not be able to take advantage of the seasonal increase in demand without further price concessions of their own. 25X1

Failure to reach an agreement that the major producers are willing to live with could touch off another round of price reductions, notwithstanding higher winter demand. Central to the outcome in Vienna and the future of OPEC is how individual members react to the Saudi move and Iraq's intention to run its new pipeline at full capacity. We expect the majority of OPEC members to emerge from the meeting pledging to abide by production quotas. Precarious financial conditions in most member countries, however, will make compliance difficult and keep downward pressure on prices. Should competition for market share intensify, prices could decline sharply—perhaps to below $20 per barrel. Nontheless, a disruption of Persian Gulf supplies would radically change this situation. Depending on the severity of the cutoff, surplus productive capacity would shrink and possible supply shortfalls could result. 25X1

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Impact of a Persian Gulf Oil Cutoff [redacted] 25X1

Iraq's recent attacks against Khark Island have increased the risk that Tehran might move to interdict oil shipments from the Persian Gulf. The cumulative effect of Baghdad's attacks has reduced Khark's export capacity by about 60 percent to less than 3.8 million b/d. With non-Communist surplus capacity now running at about 11 million b/d—almost one-half is in Saudi Arabia—the market could easily absorb a loss of exports from Iran, as well as Iraq and Kuwait. A serious problem, however, would arise if Saudi exports were also cut or if all oil shipping in the Persian Gulf were stopped. Although US imports from Persian Gulf countries are small, the United States would share the burden of any net supply shortfall as oil prices rose and oil companies diverted supplies in response to market pressures. In the event of a major disruption, oil supplies might be allocated based on the International Energy Agency (IEA) sharing agreement, which could mean significant diversion of oil from the US market to Western Europe and Japan. [redacted]

Non-Communist Oil Supplies First Half 1985 [a] *Million b/d*

	Available Capacity	Current Production	Surplus Capacity
Total	54.7	44.1	10.6
Persian Gulf	17.4	10.0	7.4
Saudi Arabia	8.5	3.4	5.1
Iran	3.3	2.4	0.9
Iraq	1.3	1.3	0.0
Kuwait	1.3	0.9	0.4
UAE	1.8	1.3	0.6
Other	1.2	0.8	0.4
Non-Persian Gulf	37.2	34.1	3.2
Indonesia	1.8	1.3	0.4
Libya	1.9	1.1	0.8
Nigeria	2.2	1.5	0.7
Venezuela	2.3	1.7	0.7
Algeria	1.2	1.1	0.1
Other	27.8	27.4	0.5

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[a] Includes NGLS.

[redacted] 25X1

Current Situation

The current combination of substantial excess production capacity and weak demand provides considerable protection in the event of an oil supply cutoff. Current available surplus capacity stands at about 11 million b/d, but only some 3 million b/d of that surplus is outside the Persian Gulf. [redacted]

Weak market conditions, however, have caused oil companies to reduce oil stocks. We estimate non-Communist oil stocks at midyear stood at roughly 4.0 billion barrels or some 85 days of supply:

- Most of current stocks represent minimum operating requirements, compulsory stocks that companies maintain to meet government regulations, and government-owned stocks. We estimate that usable commercial inventories total only about 100-200 million barrels or two to four days of consumption. This stock cushion has declined from about 20 to 25 days in the early 1980s and now provides only a small hedge against oil supply cutoffs. 25X1
- Sizable government-owned stocks are located only in the United States (486 million barrels), Japan (110 million barrels), and West Germany (55 million barrels). In July 1984 IEA members agreed to coordinate stock drawdowns and/or take "complementary action" (demand restraint) to share the burden of any economic dislocations in future oil disruptions. [redacted] 25X1

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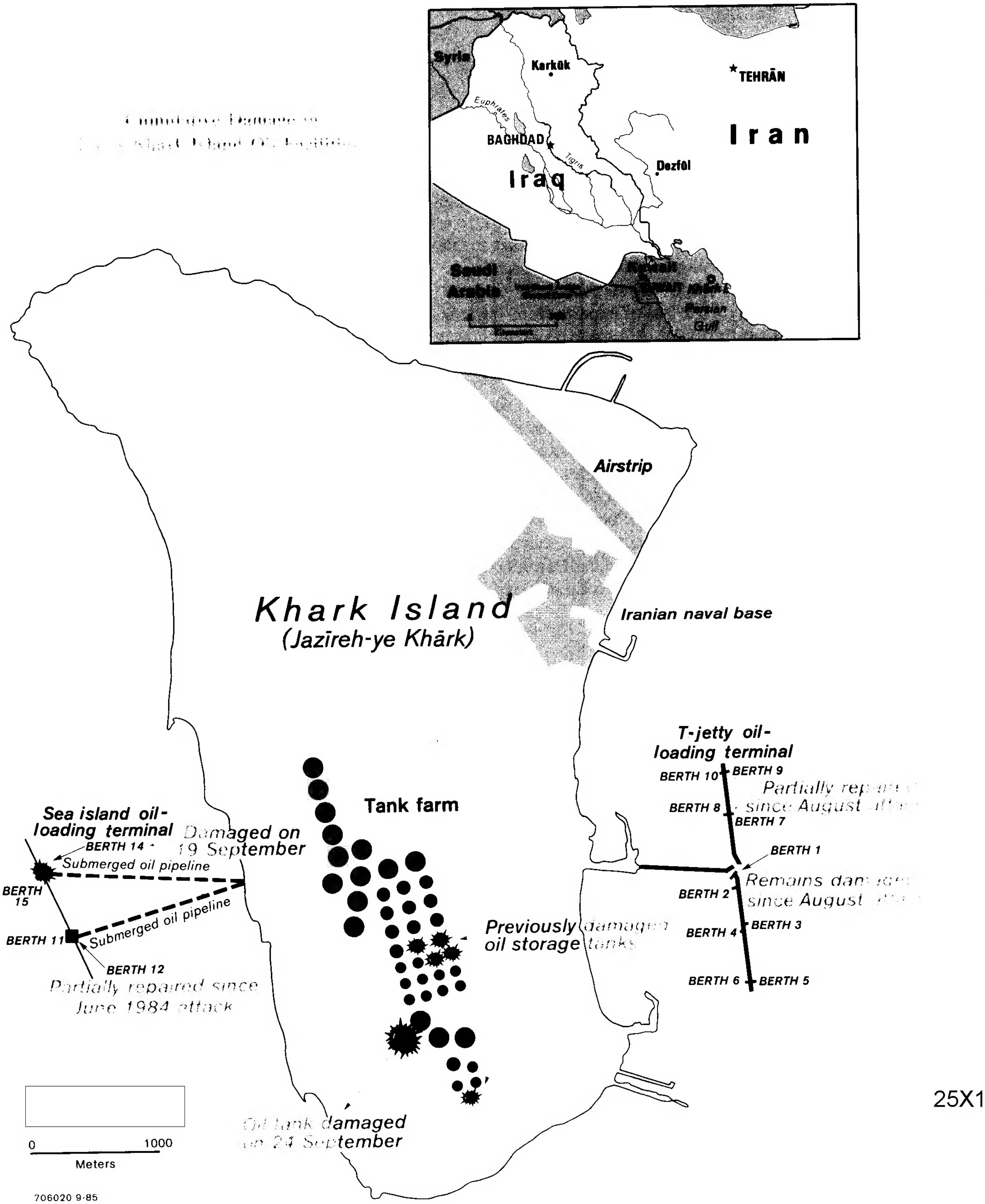
Syria
Karkūk
TEHRĀN
Euphrates
BAGHDAD
Tigris
Iran
Dezfūl
Iraq
Saudi
Arabia
Persian
Gulf
Airstrip
Khark Island
(Jazīreh-ye Khārk)
Iranian naval base
T-jetty oil-
loading terminal
BERTH 10
BERTH 9
BERTH 8
BERTH 7
BERTH 1
BERTH 2
BERTH 4
BERTH 3
BERTH 6
BERTH 5
Tank farm
Sea island oil-
loading terminal
Damaged on
19 September
BERTH 14
Submerged oil pipeline
BERTH
15
BERTH 11
Submerged oil pipeline
BERTH 12
Partially repaired since
June 1984 attack
Previously damaged
oil storage tanks
Oil tank damaged
on 24 September
0
1000
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Western Dependence on Persian Gulf Oil

Persian Gulf countries are now exporting about 7.5 million b/d, accounting for about one-fifth of total non-Communist oil supplies. Of this, some 6 million b/d flow through the Strait of Hormuz, with the remainder shipped via pipelines from Saudi Arabia and Iraq to the Mediterranean and the Red Sea. In first quarter 1985, Western Europe, Japan, and the United States relied on the region for about 18 percent, 58 percent, and 4 percent, respectively, of their total oil imports. Although Western Europe's reliance on the region has declined in recent years, several countries remain heavily dependent on Persian Gulf oil. Italy, Greece, Portugal, and Turkey received from 33 to 80 percent of their oil supplies from the region during first quarter 1985.

Damage at Khark

The ability of the Iranians to continue exporting oil from Khark Island is the linchpin of the current threat to Persian Gulf oil flows. The 19 September Iraqi attack, coupled with the cumulative deterioration of Khark's oil facilities since the beginning of the war, has substantially reduced its export flexibility and durability. Although the recent air attacks—13 since mid-August—have probably not yet reduced export capacity below recent island export levels of 1.6 million b/d, oil shipments have been disrupted for brief periods, and the flexibility and reliability have been substantially reduced.

The island's oil loading capacity has been reduced from 9.1 million b/d to a maximum of 3.8 million b/d by the recent attacks. Ongoing repairs are likely to add only another 700,000 b/d capacity within the next month. While this capacity is roughly twice recent island export levels, it is concentrated at four of 14 berths that have also been damaged by Iraqi raids during the war. It is questionable whether capacity can be maintained because of the temporary nature of the repairs, much less withstand the pressure of repeated Iraqi air attacks.

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The prospect of continued attacks against Khark combined with its increasingly fragile operating condition suggest that another major Iraqi raid could easily knock out Khark exports for an extended period. Loss of Khark would reduce Iranian export to less that 400,000 b/d from its southern Gulf island terminals at Lavan and Sirri. Oil in Iran's floating storage off Sirri could maintain recent export levels for only about one week.

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Vulnerability of Other Persian Gulf Oil Facilities

With the exception of Iraqi oil facilities, key choke points in the oil systems of other Arab Gulf countries are vulnerable to Iranian attacks. Although crude oil is now beginning to flow from southern Iraq through the spur to Saudi Arabia's East-West pipeline, the well-defended pumpstations along the Iraq-Turkey pipeline remain the most critical choke points for Iranian attack followed by the crude processing plants at Kirkuk, which serve Iraq's northern oilfields. Elsewhere in the Gulf, the most critical and vulnerable oil targets are the export-loading facilities. Saudi facilities at Ras Tanura and Ju'aymah are at risk to both Iranian air attack and commando raids, as Kuwait's Mina al Ahmadi onshore export terminal and Sea Island. While less accessible, Saudi Arabia's inland crude processing plant at Abqaiq is also an essential oil facility the Iranians might target. If key components of these facilities were damaged, it could take more than three months to reopen them even partially; repairing major structural damage could take a year. [redacted]

Impact of Oil Disruptions

The impact of a disruption of Persian Gulf oil exports in the near term would depend mainly on its severity and duration, the availability of supplies from other producers, and the use of petroleum stockpiles. Surplus available capacity is more than sufficient to offset the loss of Iranian exports, currently averaging about 1.8 million b/d. Spot prices, however, would likely rise if buyers anticipated a further spread of the conflict. [redacted]

If Khark Island were shut down and Tehran retaliated by severing the Iraqi pipeline and knocking out Kuwaiti exports, a total of nearly 5 million b/d of export capacity would be lost. Although other countries could replace these lost supplies by raising output, this would eliminate much of the surplus capacity. The uncertainties surrounding the duration of the disruption and the fear of a much more serious shortage resulting from a cutoff of Saudi exports would cause spot prices to rise. As long as Saudi export capabilities remain intact, however, oil supplies should be adequate to meet winter consumption requirements. [redacted] 25X1 25X1

Under a worst case scenario the interruption of oil flows through the Iraq-Turkey pipeline and the cutoff of all Persian Gulf oil exports—nearly 14 million b/d in Persian Gulf productive capacity would be lost to the market. Denial of access to Persian Gulf oil supplies for a prolonged period would cause a 3 to 4 million b/d net supply shortfall, almost double the size of the shortage caused by the Iranian Revolution in 1979. Under these circumstances, oil prices would rise sharply and the OECD economic recovery would be interrupted. We estimate oil prices could rise by about $5 to 10 per barrel for each 1 million b/d net supply shortfall. Furthermore, under this worst case scenario the real GNP growth rate for the OECD in the first year of the disruption could be reduced by up to 2 percentage points. [redacted] 25X1 25X1

Implications for the United States

The United States has a large stake in the continued flow of oil from the Persian Gulf in spite of the fact that US oil imports from the Gulf are less than 200,000 b/d. Although the United States could draw on non-Gulf surplus capacity to cover a loss in Persian Gulf imports, it probably would be required to share the burden of any OECD net supply shortfall either through informal company redistribution or the IEA allocation system. The IEA sharing plan can be triggered when the shortfall faced by a member country or the group reaches a minimum of 7 percent. [redacted] 25X1

Effective deployment of government-owned stocks under the terms of the IEA agreement would play an important role in offsetting any future oil supply disruption. The key players in any coordinated strategic stock drawdown would be the United States, Japan, and West Germany. The major problem would be the design and implementation of a program believed to be effective and equitable. In addition to demand restraint measures, countries without government-owned stockpiles could share the burden of a disruption by augmenting supplies through a relaxation of mandatory commercial stockpile requirements. [redacted] 25X1

[redacted] 25X1

Strategic Minerals: World Production and Reserves, 1984

Percent

South Africa				Other Producers	
Mineral	Share of Western Production	Share of World Production	Share of World Reserves		Share of World Production
Chromium	46	27	84	USSR	29
				Albania	11
				Zimbabwe	5
				Turkey	5
				India	5
Manganese	24	11	71	USSR	47
				Gabon	9
				Brazil	9
				China	7
				India	6
Platinum group	90	42	81	USSR	54
				Canada	3
Vanadium	59	30	47	USSR	33
				China	17
				Finland	11

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South Africa: Unlikely To Use Strategic Minerals Leverage

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We believe that South Africa is unlikely to react to Western sanctions by cutting off supplies of strategic minerals to the import-dependent West. A South African embargo would be counterproductive economically, lowering export earnings in the face of a debt and liquidity crisis. Moreover, an embargo would tarnish South Africa's reputation as a reliable supplier of strategic minerals and would spur substitution and recycling efforts by industrial users. Even if some limited action were taken for political reasons, we believe that such an embargo would be short lived and have limited impact on the West.

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Key Supplier

Concerns that South Africa would use its vast mineral wealth as a political lever against the West have surfaced each time Western economic sanctions against Pretoria have been suggested or imposed. South African officials themselves have occasionally hinted that a strategic mineral cutoff might be used in retaliation. What makes the threat credible is the heavy dependence of many Western countries on a variety of South African minerals:

- South Africa is the West's leading producer of chromium, manganese, platinum-group-metals (PGM), and vanadium, accounting for 24 to 90 percent of Western output. Only the Soviet Union can compete in terms of volume of production and reserves.

- Western import dependence for these four strategic minerals varies from 50 to 99 percent for the United States, 92 to 100 percent for the EC, and 70 to 99 percent for Japan. South Africa is the key supplier to most of these markets.

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Strategic Minerals: Import Dependence *Percent*

	United States		EC [a] (1983)	Japan [a] (1983)
	Share of US Consumption Supplied by Imports (1984)	Share of US Consumption Supplied by South Africa (1980-83)		
Chromium	82	55	92	99
Manganese	99	39	99	95
Platinum group	91	49	100	95
Vanadium	52	44	100	70

[a] Details on EC and Japanese imports of South African strategic minerals are incomplete.

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Minerals and the South African Economy

While mining revenues account for approximately two-thirds of South African export earnings, the importance of strategic minerals is dwarfed by the economic contribution of gold and other minerals. Gold alone accounts for nearly half of all export earnings. Diamonds and coal, not normally considered strategic, contribute an additional 10 to 11 percent. Chromium, manganese, vanadium, platinum-group metals, and ferroalloys account for no more than 9 percent of earnings, according to our estimates.

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The strategic mineral industry's contribution to South African employment also is relatively minor. The entire mining industry (including coal and

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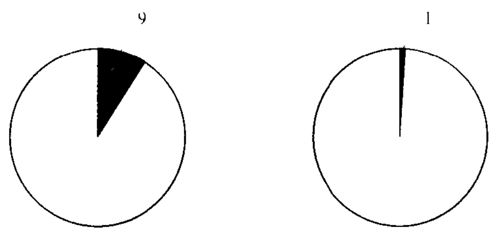
South Africa: The Importance of Strategic Minerals, 1984

Percent

Export Earnings [a] **Employment**



[a] Platinum group metals, 5 percent, ferroalloys, 3 percent, and other, 1 percent

[redacted]

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uranium) employs only 14 percent of all South African workers with the gold industry again the major player. We estimate that only 10 percent of all mine workers—1 percent of the entire labor force—are employed by the strategic minerals sector. [redacted]

Lack of Minerals Leverage

Although the South African economy is not dependent on the export of strategic minerals, an embargo at this time would deepen the current financial crisis. Over the longer term, an embargo would be more damaging:

- Gold earnings are expected to decline because of depletion of high-quality reserves, and South Africa will look to nongold exports—such as strategic minerals—to maintain economic growth.

- Any deliberate supply cutoff would tarnish South Africa's reputation as a reliable supplier, and a portion of its market share could be lost even if the embargo were later lifted.

- In addition, a supply cutoff would undoubtedly trigger accelerated substitution and recycling efforts, encourage competing producers to gear up production, and possibly lead to use of government stockpiles. The Soviet Union would probably exploit the situation, using substantial profits to offset declines in other hard currency exports. [redacted] 25X1

Prospects for an Embargo

Moreover, there is no indication that South African mineral producers are concerned that their government will take action. According to Embassy reporting, producers are more concerned that Western trade sanctions—currently confined to coal—could spread to other mineral commodities. As a result, we believe that a total embargo of South 25X1 African strategic minerals is unlikely. However, Pretoria might opt for a partial embargo as a political gesture. South Africa would lose little of its trade volume, at least in the short run, and would probably try to reorient its strategic mineral trade to other markets. In that case, we believe Western countries could survive by encouraging alternate producers to restart idled capacity, in- 25X1 creasing imports from the USSR, using stockpiled materials, intensifying recycling efforts, and, if necessary, reducing civilian usage. [redacted] 25X1

[redacted] 25X1

South African Strategic Minerals—Prospects and Vulnerabilities

Uses and Strategic Applications	South African Prospects	South African Vulnerabilities
Chromium		
Ferrochromium stainless steel specialty alloys Tanks, ships, military aircraft, naval nuclear propulsion systems	Will probably emerge as premier ferrochromium producer because of vast reserves and cheap power Low rand value will contribute to keep costs down and dollar earnings high for producers Earnings unlikely to rise dramatically—prices forecast to increase slowly	Some competition from new ferrochromium plants in Greece, India, Philippines, Finland, Sweden, and Turkey Increased substitution likely in noncritical applications
Platinum-Group Metals (PGM)		
Auto catalytic converters Electrical contacts Petroleum and chemical catalysts Jet aircraft engines Lasers	No major new competition on horizon Domestic industry in throes of major expansion to meet projected increased demand Industry controlled by three companies who adjust production to changes in demand, thus stifling substitution and recycling Consumption expected to rise as Europeans impose strict auto emissions standards	Forces depressing gold prices—strong dollar, high interest rates, and low inflation—could continue to keep lid on PGM prices despite improved market Recycling could supply up to 10 percent of world consumption by 1990
Manganese		
Ferromanganese for steel production Ships, tanks, other military vehicles	Will retain position as one of world's major producers—has large reserves Recent merger of two major producers should curb production costs and improve competitiveness	Technology will continue to lower amount of manganese used per unit of steel Consumption tied to steel demand Increased competition from Gabon, Australia, and Brazil May be unable to capture part of new Soviet and Chinese markets
Vanadium		
Steel alloys Titanium alloys Oil pipelines Jet engines	Producers willing to compete by lowering prices Rand weakness has boosted revenues	Boom-bust nature of industry likely to continue Large sales to the West by China if prices rise sufficiently

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Japan's Debt Refinancing Crunch: Much Ado About Nothing?

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Prime Minister Nakasone and the powerful Ministry of Finance will continue to use the specter of a debt-refinancing crisis to argue against increasing government spending to stimulate the economy. Tokyo remains concerned that refinancing massive amounts of debt falling due in the next few years—averaging about $45 billion annually—will disrupt Japanese capital markets. We doubt, however, that such disruption will occur over the next 18 months, chiefly because Tokyo has created more attractive, market-oriented government debt instruments and because private-sector loan demand is weak. Beyond 1986, only the combination of a sharp increase in government spending, rising international interest rates, and a domestic investment boom would make it difficult for Tokyo to raise funds and necessitate an increase in Japanese interest rates relative to the rest of the world.

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Japan: Scheduled Redemption of Central Government Debt, 1983-90 [a] *Billion US $*

Fiscal Year	Total	Construction	Deficit Financing
1983	**22.1**	21.5	0.6
1984	**25.8**	25.2	0.6
1985	**41.0**	31.9	9.1
1986	**44.5**	30.1	14.4
1987	**46.7**	28.3	18.4
1988	**41.6**	28.0	13.6
1989	**44.4**	19.4	25.0
1990	**48.2**	15.6	32.6

[a] Data as of the end of March 1984.

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Government Debt and Austerity

Rapid economic growth in the 1950s and 1960s allowed Tokyo to steadily increase government spending, cut taxes most years, and still generate a budget surplus. Beginning in the mid-1970s, however, perennial budget surpluses turned into large deficits—peaking at 5 percent of GNP in fiscal year 1979 (1 April-31 March).[1] As a result, the central government debt has grown from about $7 billion in 1974 to about $530 billion currently

To head off a financial crisis, both the government and the ruling Liberal Democratic Party (LDP) agreed in 1979 that austerity measures were needed. Nakasone in 1983 made the elimination of operating budget deficits by 1990 the centerpiece of his government's austerity campaign. Although it will probably not meet this goal, Tokyo has made substantial progress. General government outlays rose only 23 percent between 1980 and 1985, compared with a 31-percent rise in nominal GNP. The proposed budget for fiscal 1986 continues the austerity trend, with general outlays projected to increase by only 0.9 percent over fiscal 1985. Most ministries will suffer a 10-percent reduction in operating budgets—the third straight year of cuts in nominal expenditures. Proposed spending for public works, moreover, is down 5 percent for the second year in a row. The exceptions—as for the past several years—are defense (allowed a 7-percent rise) and foreign aid (up 10 percent).

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The Debt Refinancing Crunch

Tokyo's budget-cutting effort has been spurred by concern over a possible debt refinancing crunch.

[1] The government had regularly financed capital expenditures by public borrowing; deficit financing bonds, however, require an annual authorization from the legislature. The figures include social insurance trust funds

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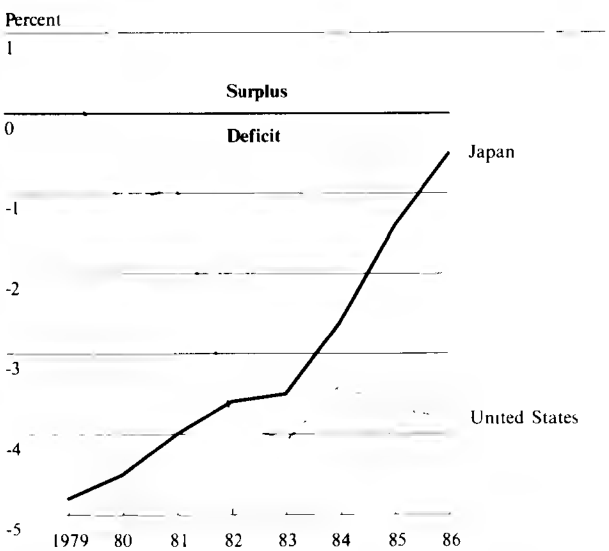
General Government Budget Balance as a Share of GNP, 1979-86[a]



[a] 1985-86 data projected. Government deficits adjusted by OECD for comparability to include social insurance programs.

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Between 1975 and 1980 Tokyo financed its burgeoning deficits by issuing 10-year bonds. Thus, the government now faces the task of refunding massive amounts of debt. Some Japanese and US economic analysts predict a serious problem in convincing the Japanese private sector to lend the government enough money to refund maturing debt without seriously disrupting the Japanese financial system. Under this scenario, the government would be forced to pay sharply higher interest rates to attract funds, thus slowing Japanese economic growth. Higher domestic interest rates would probably reduce the flow of capital out of Japan and strengthen the yen. Another common fear is that bonds with less than one year to maturity—paying relatively high interest rates for the Japanese market—would begin to drain funds from bank and postal savings accounts, which have regulated, low interest rates. The resulting drop in low-interest deposits would harm bank profitability.

Prospects for Refinancing

Despite the gloomy predictions, we believe Tokyo will have little trouble rolling over the debt coming due this year and next, as well as borrowing additional funds to finance ongoing deficits. The government has taken steps to ensure new debt issues will be welcome in the more competitive Japanese financial environment. These measures include issuing securities with varying maturities, some public auctions of government bonds, and offering short-term government bonds starting later this fiscal year. Tokyo also plans to use some funds derived from next year's sale of Nippon Telephone and Telegraph stock to refund part of the debt. 25X1

Crowding out of private business investment by government borrowing also appears unlikely in the near term. Most private investment in Japan is financed by internal funds or bank loans rather than in the bond market. Although business investment has been strong over the past year and capital outflows brisk, there is no shortage of domestic funds. The steady reduction in the budget deficit—projected to fall another $600-700 million in fiscal 1985—also reduces competition for Japan's ample savings. The first real test of the crowding-out thesis will come with the November 1985 and February 1986 refinancing of $9 billion in each month. 25X1

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Beyond 1986, we believe it is unlikely that debt refinancing would lead to sharply higher interest rates and upward pressure on the yen unless there were concurrent increases in government spending, a general rise in world interest rates, and a domestic investment boom. Unless the Bank of Japan then eased its stringent monetary policy, Japanese interest rates would probably increase relative to US rates, slowing the capital outflow. 25X1

Implications for Demand Expansion

In the past two months, influential Japanese politicians and government officials increasingly have 25X1

Impact on Financial Liberalization

Concern over a possible debt refinancing crunch provides continuing impetus for Tokyo's commitment to liberalize financial markets. The need to offer attractive financial terms to sell $50-60 billion in government bonds annually has constrained the Finance Ministry's ability to set long-term interest rates. It is no longer able to dictate terms to the bond underwriting syndicate or to force banks and securities houses to "digest" large quantities of debt at below-market interest rates. The rapid growth of the debt itself created a vast secondary market for trading government bonds—a market that dwarfs the corporate bond market—and provides a benchmark interest rate from which the government's new issues cannot far deviate. The Finance Ministry now also auctions off some shorter maturity bonds at market rates and float 15-year and longer bonds by private placement. Measures to ease refinancing, such as reducing the period that underwriting institutions have to hold the new issues before selling them to the public, have greatly increased the liquidity of government securities. [redacted]

Over the next year, the Finance Ministry plans still other moves to ease refinancing:

- *Short-term bonds (maturity of less than one year) are scheduled for issue some time this year.*
- *A bond futures market is scheduled to open in October 1986.*
- *Although the Finance Ministry still opposes the public sale of Treasury bills (now absorbed entirely by the Bank of Japan) as deficit financing measures, their use is still being studied, according to press reports.* [redacted] 25X1

The Finance Ministry remains worried about the possible impact of the maturing government debt on bank and postal savings accounts. Although the Bank of Japan has absorbed most of the bonds with less than a year to maturity, it may not continue to do so. Finance Ministry officials hope to avoid having to raise interest rates on savings deposits ahead of schedule to prevent disintermediation [redacted] 25X1 25X1

called for Tokyo to adopt measures to expand domestic demand as a method of easing trade friction with the United States. Nonetheless, Tokyo has all but ruled out increased government spending to stimulate the economy, citing the need to reduce the growth of the debt. Special government and party commissions are considering tax measures to spur private spending, but these measures are supposed to be revenue neutral. [redacted]

We believe it will become harder, however, for Tokyo to cite a burdensome budget deficit and potential debt refinancing crisis as limiting fiscal expansion. Our estimates indicate the deficit will fall below 4 percent of GNP in fiscal 1986 and will almost certainly decline further the next year. If the revenues tagged for the social security trust fund were included in the budget figures—as they are in the United States—Tokyo's deficit would be only about 1.5 percent of GNP for fiscal 1985. Debt refinancing is likely to proceed smoothly if Tokyo continues financial liberalization. Nonetheless, the strong resistance to economic stimulus is likely to continue because, in our view, top government and party leaders wish to reduce the size of the government sector in Japan. [redacted] 25X1 25X1

[redacted] 25X1

Peru: An Economy Under Siege [redacted] 25X1

Alan Garcia, sworn in as Peru's new president on 28 July, has moved swiftly to implement new economic policies to restore growth, improve social welfare, and reduce foreign dependency. He remains committed to bypassing the IMF and limiting debt servicing to 10 percent of export earnings over the next 16 months. Garcia's crusading style in launching these initial economic moves has contributed to his broad domestic popularity. As he attempts to translate this support into policy, Garcia most likely will choose between his current plan for self-imposed austerity, or a stimulative program to foster high levels of growth and job creation. Under either approach we foresee worsening economic conditions for some months and a continuing impasse in debt negotiations, which will cut off the country from the resources needed to reactivate the economy. [redacted]

The New President's Economic Views

Based on Garcia's press statements and public speeches, and on reports from sources with access, the center-left President favors highly nationalistic economic policies aimed at restoring growth and reducing foreign dependency. Externally, these include limiting debt servicing to 10 percent of export earnings over the next 16 months, promoting joint action among Latin debtors to secure easier repayment terms, criticizing "economic imperialism," strengthening controls over foreign investment, and tightening exchange controls to bolster exports and reduce imports. Domestically, Garcia stresses agricultural development to eliminate food imports and import-substitution behind tariff barriers to reactivate industry. To stabilize the economy, the new President wants to tax heavily wealthy individuals and corporations and implement tighter planning to balance the budget. We judge [redacted] that Garcia's goal is a self-imposed stabilization program, similar to those in Colombia and Venezuela, that would win support from foreign lenders without the need for a formal IMF adjustment program. [redacted] 25X1

Garcia Takes Charge

Domestic Policy. Following through on pledges given in his inaugural address, Garcia is moving to bolster living standards. According to US Embassy reporting, he first lowered domestic interest rates, froze rents, and put price controls on basic consumer goods for 90 days in a politically popular attack against inflation. He then froze dollar deposits for 90 days and devalued the currency 12 percent to reduce capital flight. Next, he placed import controls on 300 items to protect industry and foreign exchange. More recently, Garcia reduced salaries of top officials, froze government hiring, and began restructuring the agricultural and oil bureaucracy to reduce the budget deficit. He has also granted wage hikes to quell worker restiveness and promised technical and financial assistance to farmers. [redacted] 25X1

Debt and Foreign Investment. Garcia views debt as a primarily political issue because it impedes his flexibility to initiate the social welfare programs he regards as necessary to prevent political unrest. While the new President has yet to formulate concrete debt repayment schedules, US Embassy reports suggest he may follow Bolivia's example by dribbling out payments to multilateral institutions and then to government donors. Finance Ministry officials have requested that all longer term debt maturities be extended through next January, according to US Embassy and press reports. A representative of Peru's foreign bank advisory committee has visited Lima to discuss current debt policy on interest payments, but Garcia's public posture is

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Peru: Balance of Payments, 1980-85

Million US $

	1980	1981	1982	1983	1984 [a]	1985 [b]	
						Peruvian Government	CIA
Current account balance	62	−1,723	−1,613	−875	−253	−552	−395
Trade balance	837	−553	−428	293	1,007	864	1,020
Exports, f.o.b.	3,898	3,249	3,293	3,015	3,147	3,122	3,120
Of which:							
Copper	752	529	460	443	442	475	450
Oil	777	692	719	544	618	547	545
Imports, f.o.b.	3,062	3,802	3,721	2,722	2,140	2,258	2,100
Net services and transfers	−775	−1,170	−1,185	−1,168	−1,260	−1,416	−1,415
Interest payments [c]	−667	−721	−713	−828	−632	−605	−600
Capital account balance	785	1,117	1,744	1,384	1,232	675	75
Direct investment	27	125	48	38	−89	−68	−70
Amortization	−1,511	−1,520	−1,106	−1,239	−1,758	−1,344	−1,345
New borrowing	343	302	855	1,294	1,010	900	300
Short-term capital, errors and omissions	323	389	544	−552	−735	−157	−200
Arrearages	0	0	0	0	450	589	590
Foreign exchange reserves, at end of year [d]	1,979	1,200	1,350	1,365	1,630	1,460 [e]	1,000
Total debt	9,594	10,230	11,340	12,442	13,475	14,375	13,775
Debt service ratio (*percent*)	56	68	55	69	76	95	80
Debt as a share of GDP (*percent*)	44	51	56	77	80	84	80

[a] Estimated.
[b] Projected.
[c] Scheduled interest payments minus arrears.
[d] Excludes gold holdings, as reported in the IMF's *International Financial Statistics*.
[e] As of 12 July 1985.

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impeding the resumption of negotiations. Meanwhile, he recently rescinded US oil companies' contracts, citing their failure to reinvest profits, but provided 90 days to renegotiate these contracts on more favorable terms, according to the US Embassy. Recent reports indicate that similar action may be taken against Southern Peru Copper Corporation, another US venture.

Pressure Points Ahead

Reducing the budget deficit will be a problem area. We concur with the US Embassy that the direction of fiscal policy is unclear. Currently, the President is forcing cabinet ministers to reduce expenditures but is promising additional spending on pet pro-

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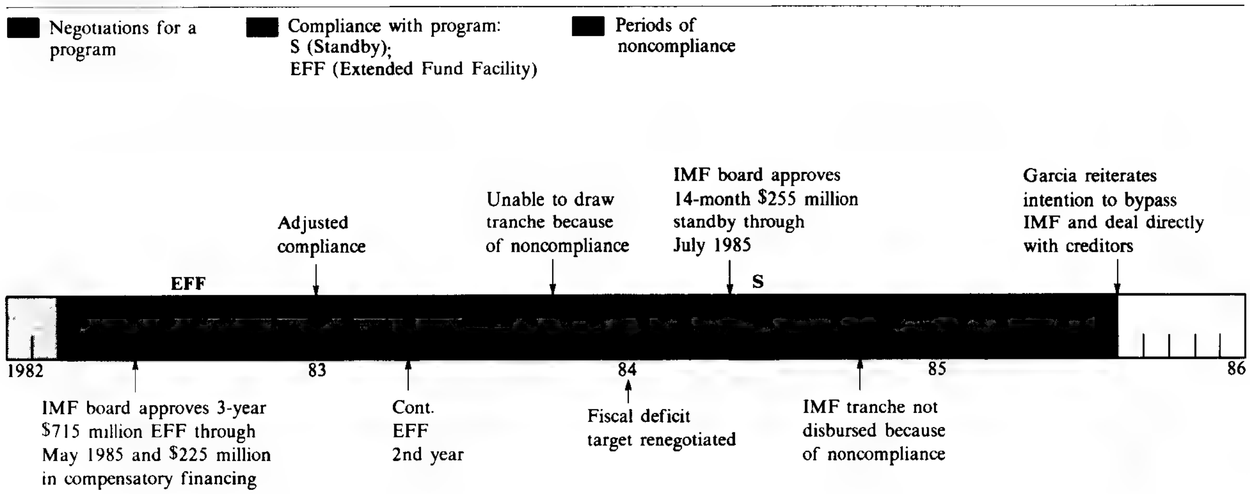
Peru: Stormy Relations With the IMF



[redacted] 25X1

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jects, such as development funds for the guerrilla-prone emergency zones. Garcia's success in keeping spending down also hinges on his ability to cope with military demands for arms purchases, traditionally one of the largest components of the government budget. The agricultural assistance program, still not well defined, could also cause significant budgetary overruns. [redacted]

Another pressure point centers on Garcia's need to regain foreign bank cooperation to resuscitate the economy. Privately, he has indicated that his tough talk on bypassing the IMF is designed to gain political support for a homegrown stabilization program. Nevertheless, many US and West European banks reportedly remain firm that no debt rescheduling can occur until Peru accepts an IMF-supported economic stabilization program. Moreover, while bankers generally are adopting a "wait-and-see" attitude, most view his unilateral cap on debt repayment as a dangerous precedent. [redacted] some US regional banks are downgrading their Peruvian loans, and credit lines for Peru have fallen one-third to $200 million since Garcia's inauguration. [redacted] 25X1

Garcia's impulsive style will pose problems for economic management. The US Embassy, for example, has reported that he did not inform Finance Minister Alva Castro of his decision to rescind US oil companies' contracts. [redacted] 25X1
[redacted]ays Alva Castro and other cabinet ministers are upset by Garcia's penchant to make policy by himself. Thus, we foresee increased tension within the administration over economic matters and the possibility, raised [redacted] 25X1 [redacted] that Alva Castro may resign around year-end to avoid becoming a scapegoat for failed economic policy. [redacted] 25X1 25X1 25X1

An Uncertain Outlook

Garcia's bold first steps have created the appearance of a government with vision and determina- 25X1 25X1

tion. Even so, Peru faces bleak economic prospects over the next 12 months, raising the risk that his promises will boost popular expectations to an unrealistic level. [redacted]

The Stabilization Scenario. Garcia's moves to streamline the bureaucracy, limit arms spending, and improve tax collection could eventually coalesce into a self-imposed stabilization program that would break the financial impasse [redacted] told US Embassy officials that higher tariffs will bolster government revenues while public spending is being restrained. Given the limit on debt repayments, [redacted] projects a small budget surplus which will work to lower inflation once controls are lifted. [redacted]

Even in the best case, we and other experts believe economic growth will fall short of last year's 3-percent rate because shortages of industrial imports and foreign credit and uncertainty will stifle domestic investment and construction. Moreover, inflation, running at an annual rate of 170 percent in July, will easily reach 200 percent as a result of a large fiscal deficit. Based on current trade returns, depressed prices for key exports will lead to another current account deficit. At best, we believe Lima will not allow any more than token interest payments, and a financial settlement probably will be delayed until next year. Meanwhile, the weak economy and uncertainty over the investment climate will most certainly discourage foreign investment. [redacted]

The Economic Disaster Scenario. Pursuit of piecemeal adjustments, aimed at protecting Garcia's popularity, however, could lead to a dramatic worsening in economic performance over the near term. Should Garcia then opt for growth and job creation—as we believe he would if his popularity were to slide because of the resurgence of inflation—increases in government investment and assistance programs would outrun tax collection, forcing the Central Bank to print money. As a result, the budget deficit could soar to a record 18 percent and push inflation beyond 300 percent, according to an econometric forecast by Peru's Development Institute. [redacted]

Peru: Selected Economic Indicators

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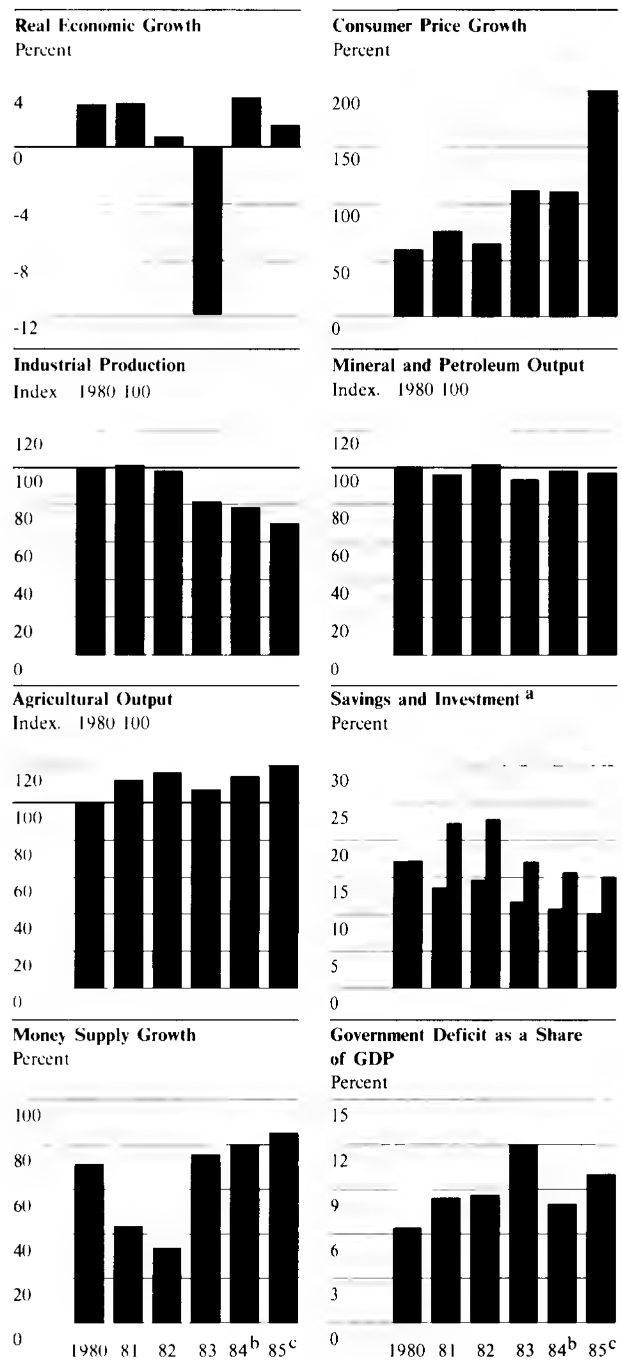

[a] Gross national savings and gross capital formation as a share of GDP
[b] Estimated
[c] Projected

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[redacted] 25X1

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Under such conditions, Garcia's continued commitment to bypass the IMF and stick to his 10-percent debt service ceiling would cause creditors to cease financial support. We believe the cash bind would intensify—in the face of weak exports and the likely cessation of trade credits—and restrain economic growth. Importing would be on a cash basis or through barter deals—already in the cards with the USSR, Israel, France, and Brazil. In our view, Garcia would continue to press for regional cooperation against creditors to obtain financial concessions and would not hesitate to use international forums to tout his goal [redacted] 25X1

Implications for US Interests

Under either scenario, we believe bilateral commercial friction will intensify. Additional import controls and prospective export subsidies could enlarge the $735 million US trade deficit recorded last year with Peru. The financial pinch probably will make Lima increasingly critical of US countervailing duty actions against Peruvian exports. Already the press is stridently criticizing Washington's "reprisals" on Peruvian steel. [redacted] 25X1

Government officials have denied that the decision to rescind US oil companies' contracts heralds nationalizations. Nonetheless, according to the communique published in Lima newspapers, if a new operating agreement is not reached in 90 days, Petroperu, the state oil company, will take control of the facilities of the three foreign oil companies. Even if the US oil companies' contracts are successfully renegotiated, we expect the contracts of other US companies to be challenged. Peru's insistence on such nationalistic policies as increased use of local supplies and suppliers is likely to scare off new foreign investment, especially if Lima also tightens remittances abroad. [redacted] 25X1

[redacted] 25X1

Haiti: Recent Economic Reverses 25X1

Haiti's inability to remain in compliance with its IMF program threatens to undo fledgling progress under the previous accord and push the economy back into a prolonged recession. Haiti faces little or no economic growth, at best, this year and severe financial difficulties that could spark renewed unrest similar to last year's sporadic food riots. International donors—increasingly impatient with the government's unwillingness to curtail extrabudgetary expenditures—are unlikely to respond to Haitian pleas for help as quickly as in the past. Unless the Duvalier regime overcomes its myopic economic policies, even benefits offered under the US-sponsored Caribbean Basin Initiative (CBI) are unlikely to entice much new investment. In these circumstances, Port-au-Prince is likely to look increasingly to Washington for a bailout as a quid pro quo for implementing US-prodded political reforms

Recent Setbacks to the Economic Upturn

Forced by its desperate economic conditions of the early 1980s to turn to the IMF for help, Haiti strictly complied with a one-year adjustment program (August 1982-September 1983) and was thus able to conclude a two-year, $63-million standby in July 1983. According to the IMF, the new agreement—slated to run until the end of this month—was designed to consolidate previous gains, boost lagging international reserves, attract foreign investment, and sustain economic growth. The government missed its first spending targets in October 1983 but achieved compliance in January 1984.

In May 1984, the regime's response to outbreaks of civil disturbances, in effect, terminated the standby program. According to US Embassy reports, eroded living standards caused by reduced government spending—especially food subsidy cuts—were largely responsible for the riots. The government instituted temporary job and food programs in the affected areas that exceeded IMF guidelines on spending. 25X1

Because of Haiti's failure to maintain compliance, IMF funding was suspended. Port-au-Prince adopted a "shadow" IMF program—an informal adjustment scheme requiring adherence to less stringent targets but providing no financial disbursements. The Fund views such programs as an intermediate stage leading to the resumption of a formal program. Nevertheless, with financial discipline broken, Haiti has failed to comply with any IMF targets. 25X1

Despite the loss of IMF funding, increased government spending and generous aid disbursements from benefactors helped the economy to grow 2 percent last year. Increased exports to the US 25X1 market also boosted Haiti's foreign payments position. 25X1

The positive growth figures, however, mask serious problems. Short-term borrowing abroad to support unchecked government spending caused the country's debt-service ratio to edge toward 15 percent last year. The spurt in public-sector spending also pushed inflation to 15 percent. Living standards also suffered from the fiscal indiscipline. Even with limited government subsidies to selected areas, food prices escalated 15-25 percent in the last half of 1984 alone. US Embassy reports indicate unemployment, despite costly make-work projects, still failed to decline. Moreover, according to the World Bank, per capita income stood at only $240—9 25X1 percent below the 1980 level in current dollars. 25X1

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A Desperate Economy

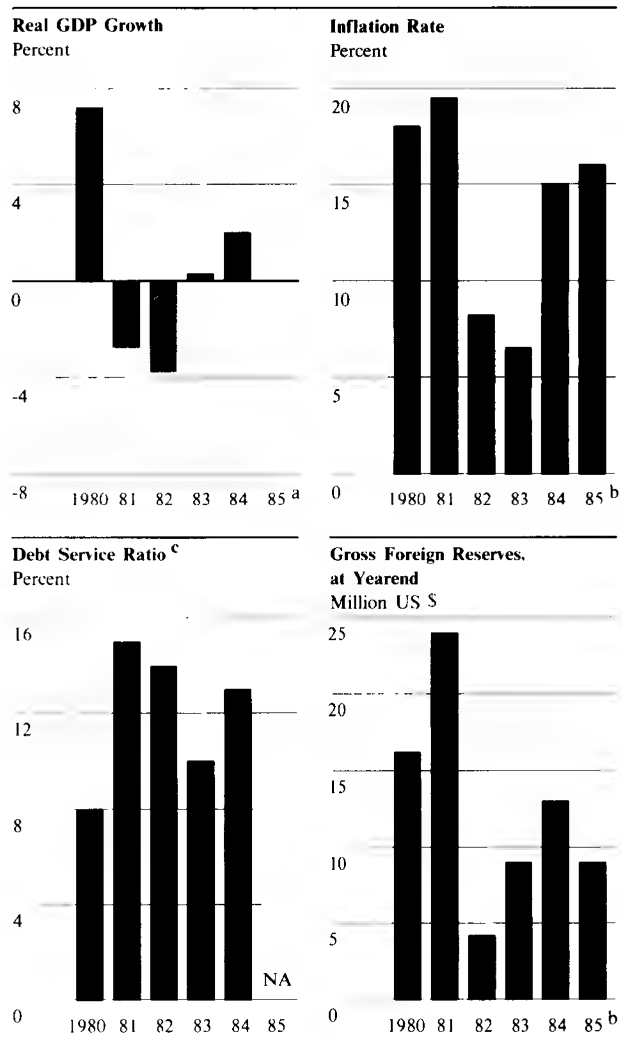
Haiti's hand-to-mouth economy foundered in 1981, and real GDP began two consecutive years of sharp decline. A hurricane destroyed one-third of the coffee crop—Haiti's primary export. The export slump came on top of unbridled public spending and sky-rocketing oil prices. Living standards—already the lowest in the hemisphere—deteriorated, and inflation continued unabated. With unemployment of at least 20 percent and underemployment in the 50-60-percent range, large-scale legal and illegal emigration flourished. 25X1

The Haitian Government grudgingly turned to the IMF for a new program—a $65-million standby running from August 1982 to September 1983. The Fund's main target was a cut in total government spending of 25 percent during the period. New sales taxes were introduced and food subsidies reduced to strengthen government revenues. The Duvalier regime also severely restricted money supply growth and imposed a moratorium on commercial borrowing for new public projects. 25X1

Haiti's efforts produced results by yearend 1983, although foreign reserves were reduced to barely one week's import cover in the process. Inflation was slashed to only 6.5 percent, and the debt service ratio was held to a manageable 10 percent. Moreover, foreign payments arrears—which had totaled nearly $20 million in 1981—were virtually eliminated. 25X1

Concessional aid from official donors—largely from the United States, France, and West Germany—nearly doubled in response to Haiti's adherence to IMF stipulations. Foreign investment also rose sharply in response to the improving economic climate. Still, living conditions improved little, and unemployment and underemployment, especially in the countryside, worsened.

Haiti: Economic Indicators, 1980-85



[a] Little or no growth projected
[b] Projected
[c] Medium- and long-term principal plus interest payments on debt of all maturities as a share of exports of goods and services

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Haiti: Balance of Payments, 1981-85

Million US $

	1981	1982	1983	1984	1985 [a]
Current account balance	−93.7	−57.5	−78.3	−65.5	−63.5
Trade balance	−192.2	−127.8	−136.6	−128.0	−128.4
Exports	176.1	206.1	222.0	256.6	278.8
Coffee	33.8	40.0	51.2	49.6	56.0
Light manufactures	54.3	66.3	73.5	88.9	95.4
Other	88.0	99.8	97.3	118.1	127.4
Imports	368.3	333.9	358.6	384.6	407.2
Oil	59.7	51.5	55.3	59.0	61.6
Other	308.6	282.4	303.3	325.6	345.6
Net services and transfers	98.5	70.3	58.3	62.5	64.9
Capital account balance	101.5	37.7	83.1	69.5	59.5
Official capital	83.9	41.2	60.2	59.0	55.9
Direct investment	42.4	45.6	63.9	62.0	67.8
Medium- and long-term loans	41.5	−4.4	−3.7	−3.0	−11.9
Net short-term capital	50.4	−8.7	25.3	5.9	6.6
Private capital, errors, and omissions	−32.8	5.2	−2.4	4.6	−3.0
Change in gross reserves	7.8	−19.8	4.8	4.0	−4.0

[a] Projected.

[redacted] 25X1

Worrisome Outlook

The IMF predicts that unless Haiti restores fiscal discipline the country will suffer another economic tailspin. Despite recent IMF talks with the government, Haiti has made no real progress toward a new IMF agreement this year. In our judgment, the regime's unwillingness to come to grips with excessive government spending and central bank credits, in particular, will prevent a return to the IMF fold. Moreover, the Fund has declared that negotiations cannot begin in earnest until Haiti repays arrears owed it—currently $16 million—and shows several months of significant progress under the shadow program. The longer Haiti remains out of compliance with the Fund program, however, the more difficult it will be to negotiate a new accord because even more draconian adjustment measures will be needed. [redacted] 25X1

[redacted] Haiti is having difficulty meeting IMF spending guidelines because President-for-Life Duvalier continues to interfere with the budgetary process. Duvalier reportedly has authorized government purchases of residences, overseas properties, and military aircraft totaling several million dollars. The US Embassy speculates that Duvalier may also be diverting funds to finance a recently formed, pro-government political party. [redacted] [redacted] Duvalier believes that, as long as the government keeps unemployment from rising and the supply of basic foodstuffs from falling, public resentment can be contained even if support from international organizations ceases. [redacted] [redacted]

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Haiti: A Snapshot of Socioeconomic Disparities

Haiti is a land of startling contrasts; jetsetters, a millionaire elite, and luxury tourist resorts coexist with urban squalor and rural destitution. The World Bank estimates that 24,000 Haitians out of a total population of 6 million own half the country's wealth. As a result, the per capita income of over 99 percent of the populace is actually less than $120 a year. In Petionville, just outside of the capital, the wealthy live on hillsides overlooking Port-au-Prince in luxury homes complete with tennis courts, swimming pools, and formal gardens. By contrast, the vast majority of Port-au-Prince's 850,000 residents live without potable water, bathe in open sewers, and many scavenge the city's garbage dumps for food [redacted]

Despite the grinding urban poverty, a private study indicates that 30,000 Haitians emigrate to the capital each year to escape the even more wretched conditions in the countryside. The World Bank estimates that per capita income in the capital is 10 times higher than in rural areas, where many Haitians live outside the money economy altogether. Moreover, less than 5 percent of the rural population has access to safe water, compared with nearly 45 percent in urban areas. Similar rural-urban disparities exist in the availability of education, health care, and other social services. [redacted]

A Comparison of Socioeconomic Indicators

	Haiti	Dominican Republic
Population, 1985 (*million persons*)	5.8	6.6
Per capita income, 1984 (US Dollars)	235	1,091
Adult literacy, 1984 (*percent*)	23	68
Urbanization, 1980 (*percent*)	35	51
Infant mortality (*deaths per 1,000 live births*)	118 [a]	28 [b]
Life expectancy (*years at birth*)	55	63 [b]
Birth rate (*births per 1,000 inhabitants*)	36	39 [b]
Population growth rate, 1970-83 (*average annual percent*)	1.7	2.7
Labor force in agriculture, 1984 (*percent*)	79	47

[a] 1980-85.
[b] 1983.

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[redacted] 25X1

We believe Duvalier will be hard pressed to achieve even these limited objectives because Haiti's domestic and foreign financial positions are likely to worsen dramatically by the end of 1985. Haiti almost certainly will deplete its meager foreign reserves and run up additional arrears to meet day-to-day expenses. Unchecked public spending will increase inflation, and further weaken the gourde, hurting Haiti's export competitiveness. Moreover, Duvalier's frivolous expenditures will do little to generate jobs or spur economic growth. We judge that stagnation is about the best the Haitian economy can hope for this year [redacted]

There is a good chance that the country will experience shortages of foodstuffs and other imported staples that could easily prompt renewed popular unrest. According to the Fund, international reserves in mid-1985 were sufficient to cover less than two weeks' worth of imports. Foreign suppliers are demanding prompt payment for such key imports as petroleum and flour, and one company reportedly recently delayed offloading oil until the government fully paid the bill. [redacted] 25X1

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A recent World Bank study reports that Haiti's brightest prospects for resuming economic growth lie in light manufacturing—especially the assembly industries. Unless the country can reach agreement with the IMF on a new program, however, potential investors will be deterred, even with the advantages offered by the CBI. Much help from other sectors is unlikely. For example, the near-term prospects for agriculture are poor because of the weak world outlook for coffee, as well as Haiti's badly eroded 25X1

soil and primitive farming methods. In addition, IMF reporting indicates that adverse international publicity from Haiti's AIDS outbreak will hurt the small tourist sector. [redacted] 25X1

US Interests

Haiti's inability to agree on and comply with an IMF program is likely to present several problems for the United States. The likely decline in capital inflows from private and multilateral sources almost certainly will prompt Haiti to look to Washington for larger sums of aid. Reacting to international pressure, largely from the US Government, Duvalier agreed last spring to legalize political parties and create a prime ministerial system. As a result, we believe Port-au-Prince will expect especially generous aid in return. Should the United States—and other key donors—not meet Haiti's expectations, Duvalier might well use the country's economic plight to justify a political crackdown on his domestic opponents. Some influential hardliners in the regime, who oppose even limited reforms, probably already are pushing for such action. [redacted] 25X1

Washington also is likely to face stepped-up illegal migration to the United States over the near term. According to a recent private study, between 1979 and 1984 as many as 40,000 Haitians illegally entered the United States. Prolonged economic difficulties are encouraging growing numbers of Haitians to seek jobs elsewhere. Many probably will head for the United States because other traditional havens—The Bahamas and the Dominican Republic—have cracked down on illegal entrants in recent years. Moreover, the lure of high US wages will remain especially strong. [redacted] 25X1

[redacted] 25X1

Egypt: Mounting Debt Woes

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Egypt's foreign payments position has turned sharply negative as a result of poor hard currency earnings. Over the next several years, Egypt will face continued payments deficits that are likely to stymie economic growth, increase public discontent, and strain the present political consensus within the country. Moreover, political constraints—particularly on the sensitive food subsidy issue—will slow the pace of any economic austerity program.

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Tightening Financial Constraints

Egypt's foreign payments position swung from a small $200 million surplus in the fiscal year ending 30 June 1984 to an estimated $1.3 billion deficit this past fiscal year, according to the IMF. The Fund predicts continued large deficits through the rest of the decade unless the Egyptian Government embarks on a "comprehensive and substantial adjustment effort." Egypt's external debt now exceeds $32 billion, excluding an estimated $2.5 billion owed the Soviet Union. Annual debt-servicing obligations have reached $3.5 billion a year—roughly one-third of current account receipts—and arrearages climbed sharply over the past year.

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Looming financial problems are taking their toll on the domestic economy. Egypt's modest surpluses helped fuel annual economic growth of around 8.5 percent between 1975 and 1983, but only 5 percent growth—at best—is projected for the next several years. Although this is relatively good growth for an LDC, it is too low for a country with total population growth of 2.6 percent annually and urban growth of 3.5 percent.

Moreover, the need to address external financial difficulties is unmasking numerous systemic deficiencies in the Egyptian economy. Subsidies, artificially low interest rates, and a complex, multitiered exchange rate system are the most notable distortions that have caused serious resource misallocations over the years. In agriculture, for example, Egypt has gone from a position of relative self-sufficiency in the early 1970s to that of importing half of its food needs at a cost of more than $2.5 billion annually. And the explicit subsidization of a wide variety of consumer goods adds nearly $3 billion annually to the government's seriously bloated budget.

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Egypt: Balance of Payments [a] *Billion US $*

	1982	1983	1984	1985
Current account balance	−2.2	−1.3	−1.4	−1.9
Trade balance	−5.1	−5.6	−6.6	−6.1
Exports (f.o.b.)	4.1	3.6	4.0	4.0
Oil	3.0	2.5	2.6	2.7
Imports (c.i.f.)	9.2	9.2	10.6	10.1
Service balance	2.8	3.8	4.5	3.3
Receipts	5.9	7.2	8.2	7.1
Remittances	2.1	3.2	3.9	2.8
Suez Canal	0.9	1.0	1.0	0.9
Tourism	0.4	0.3	0.3	0.4
Payments	3.1	3.4	3.7	3.8
Official transfers	0.1	0.5	0.7	0.9
Capital account	1.4	1.3	0.7	0.1
Balancing items	0.9	0.9	0.9	0.5
Overall balance	**0.1**	**0.9**	**0.2**	**−1.3**

[a] IMF data for Egyptian fiscal year ending 30 June of the stated year.

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position stems largely from the poor performance of Egypt's major foreign exchange earners—workers' remittances, oil sales, tourism, and Suez Canal revenues. Workers' remittances are proving to be an especially unpredictable source of income. Officially recorded receipts from the estimated 2 million to 3 million expatriate workers have fluctuated between $2 billion and $4 billion the past four years. Prospects are not good for any significant upturn in this source of revenue as long as the economic slowdown continues in the oil economies of the Persian Gulf—the area employing most of Egypt's overseas workers. The situation has been worsened by Libya's recent decision to expel Egyptian workers. Although the accumulated savings of many returning workers might provide a one-shot offset to reduced annual flows, this would be overshadowed by the added burden on domestic employment.

Oil sales have hovered around $2.6 billion the past two years—down from a $3 billion peak reached in 1982—and are unlikely to revive. The sluggish world oil market has limited sales to around 250,000 b/d and has forced Cairo to cut oil prices twice over the past year. Oil revenues also will remain constrained by the growth of domestic demand, which at more than 10 percent per year will continue to outpace production growth.

Other key hard currency earners are unlikely to pick up much of the slack. Suez Canal revenues had stabilized at around $1 billion the past few years but showed signs of declining during the first half of 1985. Growth will remain constrained largely by sluggish economic activity in the Gulf region but also by heightened security concerns about canal shipping. Tourist revenues have increased somewhat recently, according to Embassy reporting, but remain too small to have much of an impact.

Poor Borrowing Prospects

Egypt has limited access to other channels to help close its external financial gaps. Official government credits and aid are unlikely to increase much beyond what the United States is willing to offer. Supplemental US aid of $500 million over the next two years still will leave significant shortcomings, and additional requests for US relief—especially from FMS payments—are probable. The US Embassy reports that the Egyptian Government has reached a limited rescheduling agreement with the French to help on overdue payments for military equipment. On the other hand, the British Export Credit Guarantee Department—the equivalent of the Ex-Im Bank—has recently downgraded Cairo's credit rating as a result of growing arrearages. 25X1 25X1

Egypt has approached the IMF about a standby credit—about $500 million is the most widely quoted figure—but negotiations are likely to be difficult and protracted. One Egyptian official recently told the US Embassy that the government agrees with some of the IMF's criticisms, but that the Fund is wrong in pushing for exchange rate and interest rate adjustments. The Mubarak government could eventually conclude that the adjustments recommended by the Fund carry too high a political cost. 25X1 25X1

Growing concern about its creditworthiness will limit Egypt's commercial borrowing in both the United States and Western Europe. Cairo managed to repay a $200 million syndication last July, but this has done little to allay bankers' fears; the US Embassy reports that most bankers doubt Egypt could now raise a similar loan. Moreover, a spokesman for the syndicate manager voiced concern as to where the money came from and said the repayment would not alter the bank's views that the economy is entering a dangerous phase. 25X1 25X1 25X1

Outlook for Reform

President Mubarak repeatedly stresses that the economy is his top priority, and according to one Egyptian cabinet officer Egypt is unilaterally limiting new borrowing. The government already has undertaken other significant actions—at least by

Egyptian standards—over the past year, including hikes in official prices for energy and bread, some modifications of the cumbersome foreign exchange system, and an end to the policy of government-guaranteed employment for graduates. More recently, it has compiled a comprehensive economic reform package that focuses on such issues as the elimination of subsidies, increased privatization of the economy, and debt reduction—both external and domestic. 25X1

The dilemma confronting the Mubarak government is the pace of implementing reforms. Cairo appears committed to a gradualist approach for needed austerity measures to stave off worker unrest. For example, current planning envisions a five- to seven-year period for the elimination of most subsidies. Such a pace will yield few dividends in the near-term, however. Should Cairo's financial position continue to deteriorate, the regime may have to resort to progressively harsher austerity measures in a rather short period of time. For a population that over the past 10 years has had rising economic expectations, such a development may presage a fundamental shift in popular attitudes away from support for Mubarak. 25X1

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Briefs

Energy

Spot Oil Market Trends

[redacted]

Spot oil prices, which had been slowly firming since July because of OPEC production restraint, rose more sharply last week on the news of the most recent Khark Island attacks. Nigerian Bonny Light and North Sea Brent increased $0.35 per barrel from week earlier levels to $28.30 and $27.55, respectively. Arab Light prices, however, dropped slightly to $27.35 compared to the official price of $28.00—probably in response to the Saudi decision to boost sales at discounted prices. If underlying market conditions remain weak and other producers follow the Saudi lead and boost production, spot prices could begin falling despite the seasonal winter upturn in demand. [redacted] 25X1 25X1

Iraq–Saudi Arabian Pipeline in Operation

[redacted]

Iraq may begin exporting oil from Saudi Arabia's Red Sea port at Yanbu by 29 September, according to the US Embassy in Riyadh. The 500,000 b/d Iraqi spur line connecting Baghdad's southern oil facilities to the Saudi East-West pipeline became partially operational on 12 September, [redacted] 25X1 25X1 25X1

[redacted] Put into service before all metering and control equipment was installed, the system's export capacity is expected to be limited initially to less than 300,000 b/d. It should reach its designed export capacity by early 1986, adding about $4 billion in revenues annually—helping to offset reduced war aid from Saudi Arabia and Kuwait—while putting further pressure on the already weak oil market. Approval of the line's second phase could lead to Iraqi oil exports of more than 3 million b/d—near pre-war levels—by mid-1987. [redacted] 25X1 25X1

Trends in World Coal Trade

[redacted]

Although industry sources expect world coal trade to remain stagnant this year, coal exports from the United States rose 9 percent in the first half of 1985 over year-earlier levels to 38 million metric tons. The increase stemmed mainly from greater steam coal exports to Western Europe and the Far East. Polish sales to the West fell to 12 million tons in first half 1985 from 14.5 million tons in first half 1984, due primarily to the harsh winter. South African exports through the first half were running at 18 million tons, about 8 percent below last year's level. By contrast, Australian shipments were up by 28 percent over last year's first-half exports [redacted] Colombia has recently begun coal exports with sales to Israel, and expects to compete in the US, West European, and Japanese markets. [redacted] 25X1 25X1 25X1 25X1

Australian Coal [redacted]

Coal shipments—Australia's largest export earner—were up 28 percent in the first six months, over comparable 1984 levels. Steam coal exports rose significantly as a result of a 66-percent jump in deliveries to Japan, and a 25-percent increase in shipments to Western Europe. If present trends continue, total Australian coal exports could exceed 86 million metric tons this year—surpassing the record-breaking 1984 level by more than 12 percent. At these volumes, Australian coal exports are likely, for the second consecutive year, to top coal exports by the United States—historically the world's largest coal exporter. [redacted] 25X1

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Tanzania Faces Major Oil Crisis

[redacted]

A Tanzanian consignment of 600,000 barrels of Iranian crude oil is being held at Khark Island pending full payment and is incurring heavy demurrage charges [redacted] Tanzania also owes Iran more than $22 million for three shipments made earlier this year and is without the means to make payment in the near term. The only oil Dar es Salaam has received recently is 1.2 million barrels of oil from Marcotrade, a commodities trading group based in Switzerland. Marcotrade was previously implicated along with Tanzanian Ministry of Energy officials for the illegal trade of South African oil, according to press reports. Oil supplies currently on hand will last only until December, and we believe the country's depleted foreign exchange reserves and record of default will obstruct efforts to renew past agreements or find new sources [redacted] 25X1

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International Finance

OECD Export Credit Group Meeting

[redacted]

As expected, last week's Export Credit Group meeting made no progress toward tightening control over the use of tied aid credits, according to US Embassy reporting. Despite an OECD ministerial mandate to strengthen discipline over tied aid credits, France and Italy blocked the EC from accepting any changes in current guidelines, particularly any increase in the minimum grant element. Most other participants agreed that a higher grant element is needed to reduce commercially-motivated tied aid credits. In response to the lack of progress, the Chairman agreed to small group meetings between the United States, EC, Japan, and maybe Canada to provide options for the next plenary meeting in early 1986. On the positive side, a broadened definition of tied aid credits and a draft text calling for face-to-face consultations on controversial tied aid credit projects were formally adopted. [redacted] 25X1

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West Germany Reschedules Iraqi Debt

[redacted]

Iraq's ability to secure bilateral debt relief and to use oil to make repayments was demonstrated again last week when West Germany rescheduled $100 million due 1 October. The US Embassy in Baghdad reports that the payment, owed under a 1983 debt rescheduling agreement, will be stretched out to the end of 1987. Under the agreement, $60 million will be paid through oil purchases by private German companies with the rest paid in cash. Bonn, 25X1

however, refused to guarantee the oil purchases and insisted that they be at current market, rather than official, prices. West Germany agreed to the rescheduling because it wants to retain access to the Iraqi market. [redacted] 25X1

Global and Regional Developments

EC Pushing Wheat Exports With Price Cuts

[redacted]

The EC subsidy on exports of soft wheat to Egypt, Algeria, Morocco, Tunisia, and Syria has been increased by 34 percent in response to a recent US wheat sale to Egypt at a below-market price under the BICEP export enhancement program. The EC Commission justified the move—its first substantive response to BICEP—by the need to safeguard interests in its traditional 25X1
Mediterranean markets. [redacted] the Commu- 25X1
nity would be willing to sell wheat to the Soviet Union—the other significant 25X1
EC market—at about $8 below the September EC average price of $108 a ton,
[redacted] EC price cutting—fostered by a 25X1
surplus of 15 million tons from last year's harvest—will likely drive already depressed world prices even lower and add to tensions between the Community and other grain exporters. [redacted] 25X1

Britain Trying To Keep Soviet Economic Relations on Track

[redacted]

London is trying to minimize the damage to commercial relations with Moscow in the wake of last week's confrontation over diplomatic expulsions. The British press reports that Trade Minister Channon still expects to sign a new trade treaty next month. Negotiations are also continuing between Moscow and British Aerospace for the joint manufacture of the Advanced 25X1
Turboprop (ATP) aircraft, a short-haul civilian airliner that carries about 60 passengers. The British apparently are counting on the pragmatism of the new Soviet leadership to prevent a disruption in trade relations. The two countries began serious work on the new economic and industrial cooperation program following Gorbachev's visit to London last December. London probably wants a quick agreement so that British firms can benefit from imports under the 1986-90 Soviet five-year plan. [redacted] 25X1

Finnish-Soviet Trade Decline Continues

[redacted]

[redacted] trade with the USSR will 25X1
probably decline in 1985 for the second consecutive year. Although their commercial agreement requires annual balancing of trade, a fall in the price and volume of Soviet oil exports has produced a growing Finnish surplus. Oil 25X1
makes up the bulk of Finnish imports from the USSR [redacted]
[redacted] Finnish dissatisfaction with the low quality and limited range 25X1
of other Soviet goods leaves little room for increased Soviet sales to match the Finnish surplus. The Finns are especially worried that their industrial 25X1
production would suffer if exports to the USSR must be reduced to balance a lower level of trade. The Finns would prefer to buy more Soviet oil, but an increase in Soviet oil exports is unlikely because of domestic production problems. [redacted] 25X1

Growing South Korean–Chinese Economic Ties

Trade and economic contacts between South Korea and China are growing rapidly. Even with the recent slowing of Chinese purchases, total two-way trade should approach $1.5 billion this year—about double the level of Chinese–North Korean trade—making China South Korea's sixth largest trade partner. A number of joint-venture projects, particularly for electronics plants, are under discussion, and South Korean businessmen in Hong Kong are meeting directly with Chinese officials to discuss economic cooperation. Trade via Hong Kong (about half of total Chinese–South Korean trade) more than doubled in the first half of the year. Japanese press reports that Beijing has authorized direct trade with South Korea, however, are probably not true; such a move would provoke strong reaction from P'yongyang.

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National Developments

Developed Countries

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[redacted]

French Defense Spending

[redacted]

The French Council of Ministers has approved a government budget for 1986 that Paris claims will provide almost 2-percent real growth in defense spending after three years of zero growth. According to the US defense attache, defense expenditures will total $17.6 billion—a nominal increase of 5.4 percent over 1985. The overall national budget, however, is to increase by only 3.6 percent. 25X1 The French claim of a 2-percent real increase is based on unrealistically low projections of inflation. If inflation is higher, as independent economic forecasts indicate, real growth in defense spending will continue to be almost zero. France's nuclear forces will continue to receive the highest priority—about one-third of the procurement funds. The budget also allocates funds for military space programs, but does not provide funds for the planned purchase of a US AWACS aircraft or a new long-range transport to support French intervention overseas. [redacted] 25X1

Spain Pushing High Technology

[redacted]

The Spanish Government has called Washington's approval of AT&T's export license for a microprocessor plant near Madrid a major step forward for the country's reindustrialization program. The $200 million project, the first of its kind in Western Europe, is the cornerstone of Spain's ambitious National Electronics Plan, aimed at acquiring foreign technology, investment, and marketing assistance. The joint venture will design and produce custom-made microchips primarily for export to the United States, Japan, and Western Europe. We believe that this and other possible deals with multinationals will likely put within reach by 1987 the government's goals to double production and quadruple exports of electronics products. [redacted] 25X1

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Spanish Crackdown On Tax Evasion

Madrid has begun a program aimed at forcing greater compliance with tax laws to reduce the budget deficit. Unreported taxable income was estimated at 8 billion pesetas in 1984. Electronic cross-checking of data will be used, stricter laws have been passed, and an additional 500 investigators have been hired. Tax authorities will concentrate on the people in the top tax brackets where fraud is a particular problem. Madrid's efforts are likely to be effective—tax revenue in first half 1985 increased 34 percent over the same period last year. The crackdown probably will be unpopular with the business community, but the government believes this is a politically safer strategy than cutting social expenditures for the Socialists' working class constituency.

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Dutch Government Relaxes Austerity Program

The 1986 budget presented last week relaxes—but does not abandon—the austerity program followed since 1982. The new budget includes cuts of $2.5 billion in welfare spending, ministry budgets, and public-sector wages. The government calculates that a reduction in social security contributions, combined with falling inflation—forecast at 1.0 to 1.5 percent—would allow disposable income to rise by 2.5 percent, the sharpest increase in seven years. The ruling center-right coalition was unable to provide any personal income tax cuts, but corporate taxes will be cut to offset the abolition of an investment subsidy program. The deficit as a share of national income is to be reduced slightly to 7.8 percent next year. The goal of a 7.4-percent share was abandoned because of fears that additional spending cuts would hurt the coalition in the elections scheduled for next spring. While Finance Minister Ruding credited the austerity program for a reduction in inflation, the Dutch economy has mainly benefited from a strong export performance, which is not likely to continue.

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Greek Balance of Payments Worsening

The significant deterioration in Greece's foreign payments position during the first half of 1985 is likely to add impetus to Prime Minister Papandreou's plans to implement limited austerity measures. The current account deficit rose nearly 39 percent in the first six months of the year, reaching almost $2 billion. The trade deficit increased about 14 percent, as exports fell about 8 percent and imports rose slightly. Invisible receipts dipped almost 6 percent, led by declines in shipping and emigrant remittances. The current account deficit for all of 1985 will easily exceed the 1981 record of $2.4 billion. To avoid seeking IMF assistance, Papandreou probably will tighten incomes policy and reduce public spending. If the current account deficit shows little improvement in 1986, Greece is likely to find credit more difficult to obtain and probably will face debt servicing problems next year or in early 1987.

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New South African Economic Measures

Pretoria recently announced economic measures designed to demonstrate government concern over rising unemployment and economic hardship among blacks; another motive is to strengthen efforts to conserve foreign exchange. A 10-percent hike in selected customs duties will fund a $200-million increase in projects to create jobs, to assist small businesses, to expand job training, and to

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provide additional food relief. Small reductions were announced in bank interest rates, credit restrictions, and taxes on the sale of automobiles. The customs surcharge will apply to about 55 percent of South Africa's imports and will reduce import demand. The additional spending on relief for unemployment will do little to reduce the number of jobless blacks, now estimated at more than 2 million. Assistance to small businesses and expanded job training will be at least as beneficial to the 65,000 unemployed whites, Asians, and Coloreds. [redacted] 25X1

Less Developed Countries

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Libya Buying US Aircraft

[redacted]

[redacted] Libya has bought four more Lockheed L-100-30 transport aircraft—the civilian version of the C-130—to supplement two acquired earlier this year from the same Libyan-owned West German company. There are rumors in the Libyan Air Force that American technicians are to equip the first two planes with air-refueling kits. While the Libyan Government keeps looking for ways to get around US export controls on transport aircraft, aspects of this report appear questionable. Tripoli was unsuccessful in its effort this summer to get L-100s through the West German firm and probably tried another company this time. Moreover, the Libyans, who used Benin as the pickup for the earlier aircraft, probably would not use it again to avoid US detection. [redacted] 25X1

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Rumored Resignation of Kuwaiti Oil Minister

[redacted]

The Kuwaiti press reports that Oil Minister Ali Khalifa intends to resign before the National Assembly reconvenes this fall. The US Embassy in Kuwait says he tried to resign last summer following the resignation of Kuwait's Justice Minister but was dissuaded by the Amir. The Assembly has accused Ali Khalifa of malfeasance in connection with the purchase of the US-based Santa Fe Corporation, and he has been blamed for many of the negative effects of the collapse of the unofficial stock market in 1982. Ali Khalifa may have started the rumors himself to get the government to reaffirm its support for him before the Assembly opens. Even if the Amir complies, Ali Khalifa probably will go through with the resignation if the Assembly debate on the Sante Fe purchase turns bitter. The ruling family may let Ali Khalifa go in hopes of pacifying the Assembly, which could prompt critics in the Assembly to go after other targets—including Crown Prince Saad Abdullah. [redacted] 25X1

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India Chooses Europe's Airbus Over Boeing

[redacted]

Indian Airlines—India's domestic carrier—has canceled a letter of intent to purchase 12 Boeing 757s in favor of an Airbus offer of up to 31 A320s for $1.6 billion, according to the press. Airbus apparently "pulled out all the stops" in offering a combination of lower prices on advanced A320s—available later in the decade—concessional financing, and loans of free-of-charge airplanes to meet New Delhi's immediate needs. The Indian decison was probably based on estimates of a lower long-term cost of the new Airbus deal relative to the Boeing 757s. If the agreement holds, Airbus will supplant Boeing in the large and growing Indian domestic airplane market. [redacted] 25X1

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India Allows Private Investment in Petroleum Refineries

[redacted]

In a major policy shift, New Delhi has decided to allow Indian private firms and foreign partners to invest in two new petroleum refineries. The US Embassy reports that India's ambitious Seventh Five-Year Plan (1986-1990) is strapped for funds and the long-awaited refineries—which cost an estimated $2.2 billion—faced either further delays or cancellation without outside financial assistance. The government will likely retain 26 percent-ownership— 25X1 and control—with the remainder divided among the private partner and public stock issues. The refineries—which will not be on line before 1990—will boost India's refining capacity an estimated 36 percent and help ease the growing demand for imported petroleum products. The new move demonstrates Prime Minister Gandhi's commitment to economic liberalization and may will presage New Delhi's acceptance of other means of public-sector project financing to achieve its plan objectives [redacted] 25X1

Communist

Soviet Grain Purchases

[redacted]

The US Department of Agriculture reports that in the past week Moscow has purchased 1.8 million tons of US corn—the first such purchases in the 1986 market year that began 1 July [redacted] Moscow has also 25X1 purchased 4 million tons of wheat from Canada under their long-term agreement. [redacted] Moscow has been buying 25X1 Argentine wheat and sorghum and wheat from the EC and Australia. Reflecting an improved Soviet crop, Moscow to date has lined up only 10.5-12 25X1 million tons of grain as compared with 24 million tons at this time last year. So far the USSR has purchased no US wheat. Unless it buys 1.1 million tons of US wheat by 30 September, it will no longer be in compliance with its long-term agreement with the United States. [redacted] 25X1

Moscow Approves Consumer Program

[redacted]

Moscow radio has announced Politburo approval of an ambitious program aimed at increasing the availability and quality of consumer goods and services during the 1986-2000 period. The production of services and goods other than food is to grow by 30-40 and 30 percent, respectively, during the Twelfth Five- 25X1 Year Plan (1986-90). Without a much larger allocation of resources, however, the growth in output of consumer soft goods and durables probably cannot double from the estimated growth of less than 15 percent for the 1981-85 period. Resources needed to implement the planned increases are not likely to be forthcoming if the leadership follows through on its stated intention to concentrate investment on the modernization of heavy industry. Indeed, a Gosplan official in April indicated to the US Embassy that the new consumer program would not receive the needed increase in the resources. [redacted] 25X1

Soviet Industrial Statistics Withheld

[redacted]

Official Soviet statistics just released for industrial performance through August omit key indicators of growth. Growth rates are not reported for industry overall, nor for key industrial ministries or republics in the USSR, although the usual data were published for individual products. Performance in 25X1 recent months has not been embarrassing, as it has been on past occasions

when such information was withheld. Two weeks ago, however, General Secretary Gorbachev cited a preliminary estimate of industrial growth that subsequently may have been revised downward slightly. The present omissions may have been made to avoid contradicting Gorbachev's figure. Soviet industrial growth continues at a rate likely to reach 3 percent or better for all of 1985. This performance is respectable, even though it probably will not match the pace of over 3.5 percent for 1983 and 1984. [redacted] 25X1

Soviets Drop Alcoholic Beverage Statistics

[redacted]

The recent annual handbook of Soviet economic statistics for 1984 omits statistics on the production and consumption of alcoholic beverages. These were replaced by production statistics for nonalcoholic drinks and mineral water. The deletion of data on alcoholic beverages is in line with the traditional Soviet practice of withholding publication of statistics that are embarrassing or 25X1 in some other way sensitive. The timing appears to reflect the impact Gorbachev's anti-alcohol campaign, announced on 4 April. The smaller handbook of economic statistics, published in March, included statistics on alcoholic beverages. [redacted] 25X1

Hungarian Banking Reforms

[redacted]

Hungary is moving ahead cautiously with its program to create a less centralized and more competitive banking system. According to the US Embassy, the government recently created eight new institutions to finance technological development and foreign trade for state enterprises and cooperatives. The new banks will be allowed to peg their loan rates up to 1.5 25X1 percentage points above the base rate set by the National Bank. In addition, Budapest approved Citibank's plan to open a joint venture bank in Hungary that will engage in both domestic and international operations. Citibank will own 80 percent and the National Bank 20 percent. Finally, the Foreign Trade Bank is to enter the domestic lending market while the State Development Bank can now issue bonds and establish joint ventures and financial institutions. Budapest hopes these measures will improve the efficiency of credit allocation, but its wariness of excessive decentralization will limit the activities of the new banks. The new banks themselves probably will remain cautious until they develop expertise in judging the creditworthiness of firms and the profitability of investment proposals. [redacted] 25X1

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Sino-Japanese Oil Trade Dispute Developing

[redacted]

Talks last week in Beijing to renegotiate the Sino-Japanese Long-Term Trade Agreement (LTTA) were probably contentious because of serious differences over future levels of Chinese crude oil sales. Beijing is anxious to renew the agreement for another five years and increase its 160,000 b/d minimum to help offset its trade deficit with Japan—$3 billion for the first half of 1985. In view of the world oil glut, however, Tokyo wants to negotiate minimum levels annually—with no increase next year—and maintain price flexibility. China's

China's crude oil exports to Japan last year were worth $2.2 billion and accounted for 39 percent of China's exports to Japan. Beijing has been increasingly irritated by Japan's unwillingness to import more Chinese goods and invest in China. China has been selling about 60,000 additional b/d of crude on the Japanese spot market, but at prices below those set by the LTTA. If Beijing fails to get either a multiyear agreement or an increase in the annual minimum export level, it is likely to retaliate by cutting back on Japanese imports. 25X1

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